No. 15,982

United States Court of Appeals

For the Ninth Circuit

LESLY COHEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S REPLY BRIEF.

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PRELIMINARY STATEMENT.

The brief for the Respondent was received on September 11, 1958. By order of this Court Petitioner was given until September 29, 1958, to file a reply to the Respondent's brief. For convenience and clarity the Petitioner's reply will follow the numbering in Respondent's brief. References to the Transcript of Record are abbreviated (R), references to the Respondent's brief (R-Br) and to Petitioner's brief (P-Br).

In the first forty-three pages of his brief, Respondent cites an extraordinary number of cases with which Petitioner has no quarrel to establish legal principles

which are not in dispute. In the last paragraph on page 43 of his brief, Respondent finally reaches the issue before this Court, "The taxpayer's fundamental objection to the results arrived at by the Tax Court is that the Tax Court allegedly erred in holding that he had failed to show that the Commissioner's determination of deficiencies was arbitrary and invalid, and that the burden was on the taxpayer to establish that he did not owe the amounts determined by the Commissioner in the deficiency notice." It is most significant that nowhere in his brief does Respondent claim that the *original determination* was *not* arbitrary and excessive. Indeed, his failure to do so tacitly admits that the original determination was arbitrary as demonstrated in Petitioner's Opening Brief.

Respondent's position is stated on page 44 of his brief as follows: "The taxpayer here has not shown that the Commissioner's determination—*to the extent redetermined by the Tax Court*—was arbitrary or that it was excessive". (Emphasis added.) And on page 41, "nor did the taxpayer meet his requisite burden of showing that the Commissioner's determination, as redetermined by the Tax Court, was arbitrary and/or invalid". These statements show a complete misconception of the law as laid down by the Supreme Court in *Helvering v. Taylor,* 1935, 293 U.S. 507, 515. The question is not whether the determination was arbitrary or excessive *after* the Tax Court trimmed off four-fifths of it, but whether it was arbitrary and excessive as *originally determined.* Under the rule of *Helvering v. Taylor,* supra, if the original determina-

tion by the Commissioner was arbitrary and excessive the burden of proof shifted to the Respondent and it is obvious from both the Tax Court opinion and the Respondent's brief that the Tax Court judgment cannot be sustained if the burden of proof were not on the Petitioner. Apparently Respondent's theory is that the determination was not arbitrary as to that portion which the Tax Court sustained. This point might be valid where the Tax Court had sufficient evidence before it, whether produced by the Respondent or the taxpayer to prove the *exact tax liability* of the taxpayer. However, it can have no possible validity in a case like this one where the Tax Court's determination itself is admittedly based upon its finding that the burden of proof was on the taxpayer to show that he did not owe the amounts determined. The Respondent is saying, in effect, that the burden of proof is on the taxpayer because the Tax Court found deficiencies against the taxpayer because the burden of proof was on the taxpayer, an unsatisfactory attempt to lift one's self by one's bootstraps.

The presumption in favor of the Commissioner's determination has been sustained by the Courts as a necessary aid to the collection of taxes. Obviously it is a power which is susceptible to great abuse. In the hands of a tyrannical bureaucracy it could undermine our most cherished liberties. Therefore, the Supreme Court wisely restricted its use. If the Commissioner uses this great power arbitrarily, he loses the advantage of the presumption, even as to a part of the assessment that he might otherwise have collected. If

he is left with an unprovable claim, it is a hardship of his own making. The quotation from *Burnet v. Houston,* 283 U.S. 223 (R-Br 35-36), is just as applicable to Respondent, where he has forfeited his presumption, as it is to a taxpayer,

> "The impossibility of proving a material fact upon which the right to relief depends, simply leaves the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof."

Since the original determination of the Respondent was arbitrary and excessive, the presumption in favor of its validity was lost and since the Tax Court admittedly based its judgment upon the theory that the burden of proof was on the taxpayer to prove that he did not owe the amounts found by the Tax Court, it is clear that the judgment of the Tax Court cannot be sustained.

A.

Respondent's thesis, as stated in Section A of his brief, is stated as follows (R-Br 19): "The Tax Court did not err in sustaining the Commissioner's determination of the taxpayer's unreported taxable net income and the resulting deficiencies—to the extent redetermined by it—for the three taxable years involved by the use of the bank deposit method."

It should be noted that Respondent's statement that the Tax Court did not err in finding that the Commissioner's determination, *to the extent redetermined by it,* was neither arbitrary nor invalid, fails to state

that the original determination was not arbitrary. We have dealt with this matter more fully in the preceding portion of this brief.

Respondent's reference to the bank deposit method is confusing and misleading because it indicates that both the Commissioner and the Tax Court used the so-called bank deposit method. There is no similarity between the method used by the Commissioner in making his original determination and the method used by the Tax Court in arriving at the deficiencies determined by it. The Tax Court said, "We think our only proper course is to approach the problem indirectly by analysis of the record in the light of the principles established in Cohen v. Commissioner." (R. 230.) There can be no question that the bank deposit method does not clearly reflect income of a betting commissioner whose income is wholly derived from commissions. The Tax Court recognized this fact and made no attempt to sustain the Commissioner's determination under the bank deposit method. The Tax Court's discussion of the bank deposit method was directed to the question of whether or not the Commissioner's original determination had been arbitrary. The Court found that the Respondent's determination was wrong and resulted in deficiencies more than five times what the Tax Court thought represented the highest possible liability. The Tax Court's principal concern with the bank deposit method was to save the presumption in favor of the Commissioner's determination because its own findings under the Cohen rule could only be sustained

with the aid of that presumption. Otherwise the Tax Court considered the bank deposits as one of the factors indicating Petitioner's gross volume of bets.

The Commissioner himself did not follow the bank deposit method as that method is described in Respondent's brief (R-Br 21): "It has long been settled, by this Court and by other courts of appeal, that, under circumstances such as those here involved, the Commissioner, having no alternative, is at liberty to determine taxable income from third party records and other sources in order to establish, as accurately as possible, the true income, and therefore is warranted in treating as taxable income any unexplained excess of bank deposits over non-taxable and reported income."

Petitioner had reported gross income for the years involved in the amount of $131,277.75. Under the rule above stated, only the *excess* of the bank deposits over the reported income should have been set up as additional income. This is just one of the many circumstances that indicate that the Respondent was not interested in trying to establish "as accurately as possible the true income" but was intent on making a fantastically large determination, which would catch the newspaper headlines and show that the Bureau of Internal Revenue was striking hard at nationwide gambling.

Respondent cites numerous cases in which the Commissioner's right to determine taxable income from third party records and unexplained bank deposits was sustained. Petitioner has no quarrel with the cases

cited. Respondent cites no case, and we know of none, which holds that the Commissioner is permitted to make an unreasonable and arbitrary determination of deficiencies, whether based upon the bank deposit method, third party records, or any other method. The correct rule is stated in the case of *Schira v. Commissioner,* 240 Fed. 2d 672, 50 AFTR 1404, as follows:

> "In the absence of books and records the Commissioner was justified in making assessments based upon other available evidence, *provided they were not arbitrary or unreasonable.*" (Emphasis added.)

Petitioner's complaint here is not that Respondent used third party records and other sources, but rather that he deliberately disregarded available information and made a determination which he must have known did not "clearly reflect income".

B.

The Respondent's thesis under B of his brief is stated as follows: "The amounts of the taxpayer's understatements of unreported income and the resulting deficiencies were properly computed by the Commissioner—to the extent redetermined by the Tax Court—for each of the three taxable years involved."

As a corollary to this statement it would seem to follow that to the extent Respondent's proposed deficiencies were *not* sustained by the Tax Court, they were improperly computed by the Commissioner. In this, as in the other sections of his brief, hereinbefore referred to, Respondent studiously refrains from

claiming that the Commissioner's determination was not arbitrary before it was redetermined by the Tax Court.

After outlining the process which Adrian claimed that he used in computing Petitioner's income, Respondent concludes (Br 27): "In view of the foregoing, it cannot properly be said that the Commissioner's Revenue Agent, in the absence of any books or records kept and/or made available by the taxpayer, did anything other than what was necessary in order to compute the taxpayer's taxable income by the bank deposit method". We emphatically disagree. The record shows that Adrian did not make a bona fide effort to ascertain Petitioner's true income by the bank deposit method or by any other method. He was simply looking for names and information which could be used in the nationwide crack-down on gambling. He obtained most of his information from other Revenue Agents engaged in the same crack-down all over the country and naturally he wished to reciprocate. Special Agent Lund's attempt to see the books was concerned with an investigation of a different taxpayer. When Petitioner refused to make his records available at that particular time, the Respondent "threw the book at him". Adrian appeared to believe that all he had to do was "determine" a figure, regardless of how untenable and unfounded it might be, and the Commissioner's presumption would cure all defects. Adrain overlooked, and the Respondent here overlooks, that the determination must "in the opinion of the Commissioner clearly reflect income" and may

not be arbitrary. From the information available to him, Adrian could not reasonably have believed that his determination clearly reflected income. Let us recapitulate briefly the facts which show that the original determination was an arbitrary, politically-motivated determination, which Respondent knew did not clearly reflect income.

First, Adrian determined that all of the bank deposits constituted income, not merely the *excess* over non-taxable and unreported income. Thus, his determination was more than $131,000.00 too high under the authorities set for on page 21 of Respondent's brief.

Second, although he knew that Petitioner was a betting commissioner (R 200) and that his gross income would be but a small percentage of his gross receipts, he deliberately included all known gross receipts in income. If Petitioner's net commissions averaged 2½%, as seems reasonable under the Tax Court's findings, Petitioner's reported income for the three years involved would have required gross receipts of $5,251,110.00. On the same basis, in order to have secured income in the sum of $1,561,763.35, as "determined" by the Respondent, would have required gross receipts in excess of $39,000,000.00. Even if Petitioner had realized 5% on every transaction, and the Tax Court found that he did not, his gross receipts would have had to have reached $20,000,000.00 to have approximated the income "determined" by Respondent. The Tax Court, which resolved any reasonable doubts against the taxpayer and reconstructed his gross income at a figure which, in its judgment, his

income would have been unlikely to have exceeded in fact (R-Br 40) found more than four-fifths of the Respondent's determination excessive.

Third, Adrian disregarded information available to him in the Parenti audit. He secured permission from the Commissioner to reopen the two years already audited and adjusted by Parenti. He took this unusual step because of the nationwide crack-down on gambling. (R. 190.) Adrian knew that Parenti had audited Petitioner's tax returns for the years 1948 and 1949. All of Petitioner's books and records had been made available to Parenti at the time of the audit. The cancelled checks for those years, which were lost at the time of Murton's death, were available to Mr. Parenti. (R 217.) All of Petitioner's records were available to Parenti and it is worthy of note that he made no objection to Murton's method of reporting income. Respondent's attempt to pass off the Parenti audit as routine is unconvincing. Having the bank statements, which showed that Petitioner deposited $508,384.23 in the bank in 1948 and $404,-118.69 in 1949, and the cancelled checks for the two years before him, Revenue Agent Parenti did not find that the bank deposits indicated unreported income. The only additional information that Adrian had was that the taxpayer had received, and cashed or transferred, checks in the aggregate sum of $251,300.50 for 1948, 1949 and 1950. Adrian might reasonably have believed that some part of these checks constituted unreported income. He testified (R 200) that he knew that Petitioner was a betting commissioner and he

might reasonably have believed that commissions were included in these checks and thrown the burden upon Petitioner of proving how much of the total sum constituted income. He did not have the same excuse for including all of the bank deposits, even including over $131,000.00, which Petitioner had already reported. Parenti's audit and work papers must have made it perfectly clear to Adrian that all of the bank deposits did not constitute income.

Fourth, Adrian's treatment of the information that he had received concerning the Film Row Club transaction, shows that he had no interest in adopting a method which would truly reflect Petitioner's income. It must be noted that there is nothing in Adrian's testimony, or in any part of the record, to support the Tax Court's finding, and the Respondent's statement in his brief, that Petitioner indulged in personal gambling at the Film Row Club. (R 160.) The Petitioner testified, and the Tax Court found, that the Petitioner did not intentionally gamble. There is nothing in the record to support the notion of personal gambling and the Film Row Club was merely one of the many establishments with which Petitioner dealt. Knowing that Petitioner was a betting commissioner (R 200) Adrian might reasonably have determined that Petitioner made the maximum 5% commission on all Film Row Club transactions and thrown the burden of proof upon the Petitioner of proving that he made less than the maximum. This might have been rough on Petitioner, but it would not have been arbitrary on the part of the Commissioner. We must remember that

all that Adrian had was a purported schedule of wins and losses received from another Revenue Agent. He admitted that he had just as much reason to believe that the losses were authentic as he had to believe that the wins were authentic. He had no evidence whatsoever, and no reason to believe, that Petitioner ever actually collected one cent from the Film Row Club. Petitioner testified, and the Tax Court found, that Petitioner usually made periodical settlements with other betting establishments. The only logical assumption in connection with the Film Row Club would be that Petitioner paid his net losses and received nothing from the Film Row Club. Be that as it may, Adrian's treatment of the Film Row Club transaction, just as his treatment of the bank deposits, show an arbitrary disregard for the facts available to him.

Fifth, the fantastic and unrealistic amount claimed in the Deficiency Notice, the arrogant failure to state the basis of the determination in the notice, the deliberate levy of a Jeopardy Assessment of nearly $1,800,000.00, all show that the Respondent intentionally determined an arbitrary and excessive assessment as part of the nationwide crack-down on illegal gambling in 1952.

Throughout Sections A, B, and C of his brief, Respondent attempts to justify Adrian's unrealistic and arbitrary determination on the grounds that Petitioner failed to maintain adequate records, and/or, make such records available. We have already shown that the absence of books and records does not justify

an arbitrary determination. The method adopted by the Commissioner in such case must still reflect the taxpayer's income. (Sec. 22 (a) and 41, IRC 1939.) The absence of books and records does not justify the Respondent in disregarding other information which is available to him or in making a determination which he knows to be excessive. There is not the slightest reason for believing that the Respondent's determination would have been any different if the Petitioner's books and records had been made available to Adrian prior to the issuance of the ninety day letter. All of the records which Petitioner ever had (except the cancelled checks for the years 1948 and 1949, which Parenti had) were made available to Adrian and Respondent's Appellate Division prior to the trial in the Tax Court. (R 200, 203-204.) After examining Petitioner's records, the Respondent did not abate his claim by as much as five cents. His solicitude over the Petitioner's records in his brief seems a little misplaced, since he consumed a large part of the hearing before the Tax Court in opposing their introduction in evidence. (R 39, 41, 48, 52, 53, 90, 106-152.) Counsel for Respondent argued strenuously throughout the trial against the introduction of any of Petitioner's records and it is highly unlikely that Adrain would have found them any more acceptable. Murton's method of accounting for income did not purport to account for cash on the theory that the $3,000.00 cash revolving fund was relatively stable. It is quite obvious from the record in this case, and from the position taken by Respondent in other reported cases

(Louis A. Simon, p. 55324 PH Memo TC), that he would have been satisfied with nothing less than a written record giving the name and address of each person for whom Petitioner handled a bet, together with the amount of the commission received on the transaction. In the absence of such records, the Commissioner is empowered under the statute to adopt a method of accounting which will clearly reflect income, but he may not use such method to levy an arbitrary and excessive assessment.

C.

Under this heading the Respondent's brief says, "The Tax Court properly redetermined the volume of the taxpayer's bets handled and the gross commissions received thereon on the basis of his bank deposits for each of the three taxable years involved."

This section of Respondent's brief contains a glaring misstatement of fact. On page 35 he states that we contend that the Tax Court erred in treating bank deposits as gross income without allowing any deductions or eliminations therefrom for pay-outs. We made no such contention and the pages referred to, 37-41, are directed solely to the Respondent's original determination and not to the decision of the Tax Court. The Tax Court, unlike the Commissioner, did not treat gross receipts as gross income but attempted to ascertain Petitioner's commissions.

A second error in Respondent's brief has to do with the introduction of the Petitioner's records into evidence. Perhaps because the Respondent's case was

handled before the Tax Court by attorneys in the Bureau of Internal Revenue, Respondent's counsel before this Court appeared to be under a complete misapprehension in this matter. Respondent's brief not only states that the taxpayer refused to introduce his own records at the Tax Court hearing, but argues from that that the clear implication is that such documents, if offered, would have been detrimental to his case. The fact is, and the transcript clearly shows, that all of Petitioner's records were offered into evidence in the Tax Court, with the exception of the cancelled checks for the years 1948 and 1949, and those were lost.

The idea that the taxpayer attempted to withhold any documents before the Tax Court is grimly amusing to anyone who takes the trouble to read the entire transcript of proceedings before the Tax Court. Most of the trial time before the Tax Court was used by Petitioner's attorney in trying to get into evidence such records as the Petitioner had, over the vociferous and repeated objections of the attorney for the Respondent. The only books that were not actually offered in evidence were the so-called gray books, which constituted the original books of entry for the cardroom. Summaries of these books were placed in evidence (R 80), and counsel offered the books for verification by Respondent's agents. There was, in fact, no controversy ever raised about the authenticity of the cardroom records, and therefore, as is customary in Tax Court practice, counsel for Petitioner merely placed a summary of the books in evidence

and did not clutter the record with the original books themselves. Evje's testimony, which was not contradicted in any manner and which was accepted in toto by the Tax Court, shows what records were maintained under Murton's method of accounting for income, and all of these records were offered in evidence, and were admitted into evidence, with the two exceptions above mentioned, i.e., the cancelled checks for the years 1948 and 1949, which were lost when Murton died, and the gray books, of which summaries are in evidence. If counsel for Respondent had read Mr. Evje's testimony concerning what records were actually kept, and then checked the exhibits on file, they would not have made the utterly unfounded charges that Petitioner had failed to offer such records as he had.

Respondent's brief correctly states that taxpayer's fundamental objection to the results arrived at by the Tax Court is that the Tax Court erred in holding that he had failed to show that Commissioner's determination of deficiencies was arbitrary and invalid and that the burden was on the taxpayer to establish that he did not owe the amounts determined by the Commissioner in the Deficiency Notice. For the reasons set forth here and in our Opening Brief we believe that this contention is correct and that the undisputed facts in the record show that the Commissioner's determination was arbitrary. We have pointed out at various places, supra, that Respondent has failed to claim that the original Deficiency Notice by the Respondent was not arbitrary and excessive.

Respondent has not attempted to answer Petitioner's contention that the original determination was arbitrary. (R-Br 42.) "We believe that a detailed discussion of the numerous items of income, etc., complained of variously by the taxpayer (Br 32-53) which were given full consideration and effect by the Commissioner in his determination and by the Tax Court in its findings and redetermination (R 207-243) is unnecessary". The pages of Petitioner's Opening Brief referred to cover all of the reasons why the Respondent's original determination was arbitrary and also a discussion of the errors in the findings of the Tax Court. Since Respondent has not discussed these matters, we shall submit them to the Court on the basis of our original brief. We can only note that the Respondent has made no attempt to answer the arguments contained in the portion of our opening brief referred to.

II.

In this section of his brief Respondent states: "The Tax Court correctly found, upon the entire record, that a part of the deficiencies in taxes were due to fraud with intent to evade taxes". In discussing the fraud issue the Respondent's brief advances no arguments that the Tax Court's opinion did not present with greater clarity and much less wordage. Our answer to the Tax Court argument in our opening brief is equally applicable to Respondent's argument here. All of the arguments in support of the fraud penalties are based upon one erroneous premise, that is, that there is sufficient clear and convincing evi-

dence in the record, unaided by the Commissioner's presumption, to support the Tax Court's findings.

Respondent has failed to distinguish between findings made upon clear and convincing evidence and findings based merely upon Petitioner's alleged failure to carry the burden of proof. For example, Respondent says (R-Br 48): "Specifically, the Tax Court found, upon the evidence, that the taxpayer had understated and failed to report taxable income in the total amounts of $110,204.87, $78,725.09, and $99,792.29 . . .". Of course, the Tax Court found nothing of the kind *upon the evidence.* The Tax Court found that it was unlikely that Petitioner's income had, in fact, exceeded specific sums in the respective years and that he had failed to prove that it was a lesser amount. This is a far different thing than a finding based upon the evidence in the case. Without the aid of the presumption which the Tax Court said existed in favor of the Commissioner's determination, the Tax Court could not have found a deficiency for a single cent.

The Tax Court based its crucial findings upon "a painstaking analysis of all of the evidence in this case" (R 245) and the evidence so analyzed is listed by the Court as follows:

1. "The minimum volume of lay-off bets indicated by the deposit of checks and money orders from out-of-town betting commissioners"; and "undeposited checks and money orders from the same sources";

2. "Checks of Petitioner to betting commissioners";

3. "The fact that the remittances to and from Petitioner usually represented the settling of accounts rather than individual bets";

4. "The added fact that Petitioner's local cash business was a substantial part of his betting commissioner's activities,"

5. "Recognizing the percentages he received,"

6. "And making allowance for splitting of commissions on out-of-town business,"

7. "Occasional foregoing of commissions,"

8. "Occasional losses,"

9. "And the fact that Petitioner received commissions on horse race bets only from the loser,".

It is obvious that there is no clear and convincing affirmative evidence in the record which would enable the Tax Court's "painstaking analysis" to be anything but a mere guess. The income taxes reported, and paid, by Petitioner for the three years in question could have required a volume of bets in excess of $5,000,000.00. There is nothing in the record upon which the Tax Court could conclude, from clear and convincing evidence, that Petitioner's gross volume exceeded $5,000,000.00 for the three years. If the Tax Court thought that there was such evidence it should have made specific and definitive findings to that effect. Let us examine in detail each of the factors that the Tax Court said that it took into consideration:

1. *The minimum volume of lay-off bets indicated by the deposit of checks and money orders from out-of-town betting commissioners.* The total amount of

the checks deposited in the bank was $1,195,632.72 and the checks received and cashed or endorsed to others totaled $251,300.50, and the cash deposited in the bank was $22,895.00. (R-Br 26.) Thus the total volume of such bets actually proved in the record by clear and convincing evidence is less than $1,500,000.00 for the entire three years.

2. *Checks of Petitioners to betting commissioners.* The Court found that these checks for the year 1950 exceeded $290,000.00. There is no clear and convincing evidence as to what checks were issued in 1948 and 1949. However, if we assume that the same general pattern of payment by check existed in 1948 and 1949, the total amount might aggregate $1,000,000.00.

3. *The fact that the remittances to and from Petitioner usually represented the settling of accounts rather than individual bets.* Just how the Court could take this matter into consideration is not clear. There is no clear and convincing, nor in fact any, evidence before the Court which would enable the Court to make any findings in this respect. Any specific check might have been in settlement of one bet, or two bets, or more than two bets. It is ridiculous for the Tax Court to say that it took into consideration a factor concerning which there was not one iota of evidence.

4. *The added fact that Petitioner's local cash business was a substantial part of his betting commissioner's activities.* Although there is no evidence on the point, the Court assumed that the volume of local business would at least equal the volume of out-of-town business. If this were true, the total would still

be within the possible $5,000,000.00 total; that is, $1,500,000.00 for the bank deposits and checks cashed, $1,000,000.00 for pay-outs to commissioners, and $2,-500,000.00 for local bets.

5. *Recognizing the percentages he received.* Presumably the Court is referring to the maximum commission of 5%.

6. *And making allowance for splitting of commissions on out-of-town business.* How could the Tax Court make any allowance for splitting commissions in the absence of any specific evidence in the record? The only testimony is to the fact that Petitioner laid off bets when he could not place them locally. This would indicate that virtually all out-of-town bets required a splitting of the commission with the out-of-town broker.

7. *Occasional foregoing of commissions.* Obviously, the Tax Court had no evidence as to how many times, or in what proportions, Petitioner was compelled to forego commissions.

8. *Occasional losses.* Petitioner testified to substantial losses due to his inability to collect from brokers in 1950. The Court does not tell us to what extent it took losses into account and except for the year 1950 there is no evidence in the record which would enable the Court to properly take losses into account.

9. *And the fact that Petitioner received commissions on horse race bets only from the loser.* This is a crucial point in the "painstaking analysis". This might make several millions of dollars difference in

the gross handle and the Court says that it took the matter into consideration. In the absence of specific findings we do not know to what extent the Court took this matter into consideration, but it is obvious that whatever consideration it gave was simply a guess, unsupported by any clear and convincing evidence in the record. The Tax Court says in its opinion that in making this painstaking analysis it resolved any doubts against the Respondent with whom the burden of proof of fraud lies. (R 245-246.) We would understand from this that the Tax Court took that view of the evidence which would be most favorable to Petitioner. Therefore, it should have determined that the greater proportion of Petitioner's business consisted of bets on horse races and this is undoubtedly the fact as demonstrated in our opening brief. (P-Br 48.) Then the Court should have found (if it were really resolving all doubts against the Commissioner) that Petitioner was compelled to split the commissions on horse races with out-of-town brokers. In other words, Petitioner's net commissions on horse race bets, which were laid off with out-of-town brokers, could only average about one and one-quarter per cent. Five per cent on the loser's side of the horse race bet in the long run should average out about 2½% of the entire bet and one-half of that to the out-of-town broker would leave the Petitioner with one and one-quarter per cent.

The Court also said, "Our analysis likewise convinces us that a large part of the understatements in each of the said years was attributable to Petitioner's

failure to include in his return the receipts of commissions in cash". (R 246.) This conclusion is likewise unsupported by any clear and convincing evidence. The record shows that Petitioner used cash to purchase cashier's checks and money orders to pay out-of-town bettors. (R 211.) The record does not show how much cash was expended in this manner, but if the Tax Court is really going to resolve all doubts against the Respondent upon whom the burden of proof lies, it would have to have that information and make a specific finding thereon. Petitioner testified that he maintained his cash balance at around $3,000.00. The Tax Court says that an analysis of the facts demonstrates the contrary, but unfortunately it fails to find facts to support its conclusion.

Murton's method of accounting for income would account for all of Petitioner's income from commissions if it were honestly carried out, that is to say it would account for all net receipts unless Petitioner secreted cash over and above the $3,000.00 revolving fund. There is no clear and convincing evidence in the record that he did so. His net worth, his manner of living, and the amount of income reported on his income tax returns are entirely consistent with his having reported all of his commissions. Whether or not this Court sustains the deficiencies in income taxes found by the Tax Court depends largely upon whether or not it agrees with the Tax Court that the Commissioner's original determination was not arbitrary. We do not have the same problem in connection with the fraud penalties. The Tax Court recognizes that all

doubts must be resolved against the Commissioner who has the burden of proving fraud, but as we have demonstrated above, it failed to do so. There is no clear and convincing evidence in the record, resolving all doubts against the Respondent, which would justify a finding that there was any deficiency in income taxes for any of the three years. Since no deficiencies were proven, Respondent's argument that the intent to evade tax may be inferred from a continuous failure to report income is inapplicable.

CONCLUSION.

For the reasons set forth herein, and in our opening brief, we submit that the judgment of the Tax Court should be reversed.

Dated, San Francisco, California,
September 29, 1958.

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